

## **STAFF REPORT TO THE COMMISSION**

December 9, 2003

**SUBJECT:** Illinois Power Company Notice to the Commission that it is entering into a First Amendment to the Sublease dated as of October 1, 1999 between Illinois Power, as sublessor, and Dynegy Midwest Generation, Inc., as sublessee pursuant to Section 16-111(g) of the Public Utilities Act, as amended by the Electric Service Customer Choice and Rate Relief Law of 1997.

### **Capsule Summary**

November 14, 2003, Illinois Power Company ("IP") filed a notice to the Commission of the amendments to the sublease between IP and Dynegy Midwest Generation, Inc. ("DMG"), which provides for IP's exercise of its Purchase Option under the lease and the subsequent delivery of the Bill of Sale with respect to ABN AMRO's interest in the Tilton CT Units to DMG. According to the accounting entries attached to the notice, IP intends to record a sale of electric plant to DMG in the amount of \$66,400,000, and an "account[ ] receivable from associated companies" from DMG in the amount of \$66,400,000. The amendments to the sublease between IP and DMG will, according to the notice, be effective December 12 or 14, 2003.

### **Background**

On March 31, 1999, IP filed a Notice to the Commission of the Transfer of Certain Assets Pursuant to 220 ILCS 5/16-111(g) ("March 1999 Notice"). IP stated that it was transferring certain assets, including the CT Units at Tilton Energy Center, to an unaffiliated special purpose entity "to obtain off balance sheet financing of the Assets whereby Illinois Power's interest in the Assets will be treated for accounting purposes in a manner similar to a lease of the Assets under an operating lease."

On April 16, 1999, IP filed a notice of transfer of certain generating facilities ("April 1999 Notice"), which included the Tilton CT Units, to Illinova, its corporate parent, which was then to transfer the generating facilities to another of its subsidiaries, Illinois Power Marketing, Inc., also referred to in the April 1999 Notice as "WESCO." On April 21, 1999, the Commission issued an order initiating Docket No. 99-0209 pursuant to Section 16-111(g)(vi) of the Act to determine whether IP's proposed sale of the electric generating plants listed in the April 1999 Notice should be approved or prohibited. On July 8, the Commission entered an Order in that proceeding which approved the transfer of Illinois Power Company's fossil generating station assets, as described in Section III of the Order, including "[a]ll real and personal property owned by IP at the Tilton combustion turbine ("CT") site as well as all leasehold interests and contract rights in connection with the Tilton site and the four CT units being installed at that site (except for transmission and gas supply assets remaining with IP)."

On July 14, 1999, IP filed another Notice to the Commission of the Transfer of Certain Assets Pursuant to 220 ILCS 5/16-111(g) ("July 1999 Notice"). The July 1999 Notice, by its terms, "amends and modifies the notice previously delivered to you on March 31, 1999". The new notice

of the transfer of assets included only the Tilton CT Units, and stated that they would be transferred to ABN AMRO Bank N.V. ("ABN AMRO") instead of to the SPE. Quoting that Notice:

The Assets will be transferred as part of a sale/leaseback transaction which will enable Illinois Power to obtain off balance sheet financing of the Assets whereby Illinois Power's interest in the Assets will be treated for accounting purposes in a manner similar to a lease of the Assets under an operating lease. Under the sale/leaseback transaction, Illinois Power will retain full operational use and control of the Assets."

Amended Notice, page1

Transfer of the CT units to the Bank as part of the off-balance sheet financing will not affect IP's use and control of the CT Units, or its need for a permanent certificate, under the sale/leaseback arrangements. Illinois Power will have full responsibility and entitlement to use, operate and maintain the CT Units and associated facilities on an "as if owned" basis.

Amended Notice, page 2

On September 10, 1999, ABN AMRO Bank purchased the Tilton CT Units, and under the sale/leaseback agreement, IP then leased the Tilton CT Units from ABN AMRO. IP also entered into a sublease for the units with Illinova subsidiary WESCO.

### **The November 2003 Notice**

On November 14, 2003, IP filed a notice ("2003 Notice") with the Illinois Commerce Commission ("Commission") pursuant to Section 16-111(g) of the Public Utilities Act ("Act"). The Notice states that IP "is entering into a First Amendment to the Sublease dated as of October 1, 1999 between Illinois Power, as sublessor, and Dynegy Midwest Generation, Inc. ("DMG. . ."), as sublessee, relating to . . . [the "Equipment", consisting of] the combustion turbine ["CT"] generating units and associated equipment located at the site commonly referred to as the Tilton Energy Center." According to the Notice, "[t]he purpose of the Amendment is to clarify that, as a result of Illinois Power exercising the 'Purchase Option' under that certain amended and restated Participation Agreement dated October 20, 2002, by and among Illinois Power, as Lessee, ABN AMRO Bank, N.V., as Agent Lessor, and certain other participants, DMG will be designated as the recipient of the Equipment, and will be entitled to receive delivery of the Bill of Sale for the Equipment from the Agent Lessor."

The Notice further states that "[t]he Amendment will clarify that upon termination of the Participation Agreement, Illinois Power's residual interest in the Equipment, as lessee, will be transferred directly by the Agent Lessor to DMG, DMG will reimburse IP for the purchase price due from IP to the Agent Lessor for the residual value of the Equipment, and the Agent Lessor will deliver the Bill of Sale for the Equipment to DMG. The end result will be that DMG will be the owner of the Equipment, and Illinois Power will be fully reimbursed by DMG for the purchase price of the Equipment that IP will owe the Agent Lessor pursuant to the Participation Agreement."

One of the "Attachments to Notice Letter" is entitled "First Amendment to Sublease." That document contains the following recitals:

WHEREAS, Sublessor and Sublessee are parties to that certain Sublease dated October 1, 1999 (the "Sublease") by and between Sublessor [IP] and Sublessee [DMG], pursuant to which Sublessor subleases to Sublessee certain Equipment; and

WHEREAS, pursuant to Article III of the Sublease, Sublessee is obligated to pay to Sublessor, as Rent, all amounts owed by Sublessor to Agent Lessor under the Lease, including the Purchase Amount payable by Sublessor to Agent Lessor pursuant to Section 19.1(a) of the Lease following exercise of the Purchase Option upon expiration of the Lease; and

WHEREAS, pursuant to Section 21.1(a) of the Lease, Sublessor is entitled to cause the bill of sale with respect to the Equipment (the "Bill of Sale") purchased upon exercise of the Purchase Option to be delivered to Sublessor's designee; and

WHEREAS, it has been and is the intention of the parties that Sublessee be the recipient of (and designee with respect to) the Bill of Sale in the event the Sublessor elected to exercise the Purchase Option under the Lease, and this Amendment is made for the avoidance of doubt to expressly state that intention of the parties; and

WHEREAS, on September 15, 2003, Sublessor delivered notice of its intention to exercise the Purchase Option upon the expiration of the Lease in September 2004; and

WHEREAS, the parties desire to amend the Sublease to reflect the foregoing intent and obligate Sublessor to cause Agent Lessor to deliver the Bill of Sale to Sublessee upon exercise of the Purchase Option;

NOW, THEREFORE, in consideration of the foregoing, and of other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Sublessor and Sublessee agree as follows:

[November 2003 Notice, first attachment, page 1]

The First Amendment to Sublease itself changes certain definitions, and adds a new Section 3.3 as follows:

*Section 3.3. Exercise of Sublessor's Purchase Option.* In the event the Sublessor exercises its Purchase Option under Section 19.1(a) of the Lease, with respect to which the Sublessee is obligated to pay the Purchase Amount, then upon termination of the Lease with respect to the Equipment, the Sublessor shall instruct the Agent Lessor, in accordance with the Sublessor's rights arising under Section 21.1(a) of the Lease and upon payment to the Agent Lessor of the Purchase Amount, to deliver to the Sublessee, in

the name of the Sublessee, the bill of sale with respect to Agent Lessor's interest in the Equipment.

[November 2003 Notice, first attachment, page 2; emphasis in original]

Reading the letter notice together with the Recitals and the substantive amendment to the Sublease quoted above, and taking into account the fact that IP has already expressed to the Agent Lessor its desire to exercise the Purchase Option of September 10, 2004, Staff can only conclude that IP is, by this notice, informing the Commission that it is contractually binding itself to an assignment of all of its interest in the Equipment to DMG.

A comparison of the April 1999 Notice to the November 2003 Notice is instructive. The April 1999 Notice was for the transfer by IP of the Tilton Energy Center Equipment (or of its rights under the lease resulting from a sale and leaseback) to Illinova for subsequent transfer to another IP affiliate in the Illinova system. The November 2003 Notice is for IP action to contractually bind itself to the transfer of the right to own the Equipment to Dynegy Midwest Generation, a subsidiary of Dynegy, Inc. ("Dynegy"). Dynegy became the corporate parent of IP as the result of a reorganization that occurred after the Commission's consideration of the fossil plant transfers to Illinova in Docket No. 99-0209. While both Notices contemplate the transfer of property rights by IP in exchange for an affiliate's promise to pay, Staff believes that the newly filed Notice may bear close scrutiny because of differences between the financial circumstances of Illinova and its subsidiaries in 1999, and those of Dynegy and its subsidiaries in 2003.

### **Requirements of the Public Utilities Act**

Under Section 16-111(g) paragraphs (i) (ii) (iii) & (iv) an electric utility providing the Commission with notice of the sale, assignment, lease, or transfer of assets of any kind has certain informational filing requirements:

- 16-111(g) - An electric utility has to give the Commission a thirty-day notice of the transaction.
- 16-111(g)(i) - An electric utility shall provide a complete statement of the accounting entries it will make upon completion of the transaction and a certificate from an independent CPA stating the entries are in accordance with GAAP. If the transaction involves an affiliate and there are Commission guidelines for cost allocations between the utility and its affiliates, the notice must include a certification from the chief accounting officer of the electric utility that the entries are in accordance with those guidelines.
- 16-111(g)(ii) - An electric utility shall provide a description of how it will use the proceeds of the transaction to reduce debt or otherwise reduce or recover the costs of services provided by the electric utility.
- 16-111(g)(iii) - An electric utility shall provide a list of all other approvals required by State or federal agencies or departments it has or will obtain before the transaction is implemented.

- 16-111(g)(iv) - An electric utility shall provide an irrevocable commitment that the transaction will not result in the imposition of any stranded cost charges that might otherwise be allowed to be charged to retail customers under federal law or increase the transition charges that might otherwise be allowed under this Article XVI.

Section 16-111(g)(v)-(vi) sets forth additional filing requirements if the generating capacity of the plant sold, assigned, or leased is 15% or greater of the utility's net generating capacity as of the date of the Act, December 16, 1997. If the capacity exceeds the 15% threshold, Section 16-111(g)(vi) authorizes the Commission to initiate a proceeding to determine whether it should approve or prohibit the proposed transaction based upon the standards set forth in that provision.

### **Amount of Net Dependable Generating Capacity Assigned**

As noted above, IP's April 1999 Notice resulted in Docket No. 99-0209, a proceeding in which the Commission considered IP's proposed sale of some 80% of its net dependable generating capacity as of December 16, 1997, under the standards set forth in Section 16-111(g)(vi) of the Act. The Commission concluded on the basis of the evidence in that case that it should approve the transfer of IP's fossil generation assets, including the Tilton Energy Center Equipment.

The generating capacity of the four combustion turbine generating units at the Tilton Energy Center (the "Equipment" the ownership rights in which are to be transferred to DMG under the terms of the November 2003, Notice) is approximately 44 megawatts ("MW") each, for a total of approximately 176 MW. According to information furnished to Staff by Illinois Power on December 17, 1998, Illinois Power's net dependable generating capacity as of December 16, 1997 was 4663 MW winter capacity and 4571 MW summer capacity.

According to other information furnished to Staff by IP in December 1998, the net dependable capacity of the plants the transfer of which was the subject of Docket No. 99-0209 was 3714 MW winter capacity and 3641 MW summer capacity. Even without the 176 megawatts of Tilton Energy Center capacity, then, the amount of net dependable generating capacity transferred under Section 16-111(g) as a result of the April 16, 1999, notice and the Commission's action in Docket No. 99-0209 far exceeded 15% of the net dependable generating capacity as of December 16, 1997. The net dependable generating capacity of IP's proposed Tilton Energy Center Equipment assignment, when added to net dependable generating capacity IP has already transferred under Section 16-111(g) (exclusive of any leasehold rights previously transferred by IP), must therefore, "bring[] the amount of net dependable generating capacity transferred pursuant to [subsection (g) of Section 16-111 of the Act] to an amount equal to or greater than 15% of its net dependable capacity on the effective date of this amendatory Act of 1997."

### **Conclusion**

The Accounting Department has reviewed the November 14, 2003, notice filed by Illinois Power Company. The notice was filed within thirty days of the sale and has met the requirements of Section 16-111(g)(i) - (iv).

The 2003 Notice does not, however, mention or fulfill the requirements imposed with respect to a noticed transaction that “brings the amount of net dependable generating capacity transferred pursuant to this subsection to an amount equal to or greater than 15% of its net dependable capacity on the effective date of this amendatory Act of 1997.” Based on the analysis set forth above, Staff’s view is that the 2003 Notice, including the attachments, would effectuate an assignment of IP’s right to own the Tilton Energy Center Equipment to DMG. Staff thus views the transaction as subject to the additional requirements of Section 16-111(g)(v) and (vi), and recommends that the Commission initiate a proceeding to determine whether the proposed transaction should be approved or prohibited under the standards set forth in Section 16-111(g)(vi).

Section 16-111(g)(vi) addresses the time for completion of a proceeding to consider a notice subject to that provision in this way:

Any hearing initiated by the Commission into the proposed transaction shall be completed, and the Commission's final order approving or prohibiting the proposed transaction shall be entered, within 90 days after the date the electric utility's notice was filed.

Given the omission of required information from the November 2003 Notice, Staff recommends that the Commission, subject to considering any evidence or legal argument to the contrary that it may receive, state that it cannot be bound by the 90 day timeline imposed by Section 16-111(g)(vi) until such time as IP has complied with all of the filing requirements of Section 16-111(g)(v) and 16-111(g)(vi). In other words, Staff recommends that the Commission construe the quoted language as providing it with 90 days to consider a properly filed notice.

Staff also recommends that the Commission consider, as an independent basis for initiating this investigation, its obligations under Section 4-101 of the Act. In pertinent part, that Section provides as follows:

The Commerce Commission shall have general supervision of all public utilities, except as otherwise provided in this Act, shall inquire into the management of the business thereof and shall keep itself informed as to the manner and method in which the business is conducted. It shall examine those public utilities and keep informed as to their general condition, their franchises, capitalization, rates and other charges, and the manner in which their plants, equipment and other property owned, leased, controlled or operated are managed, conducted and operated, not only with respect to the adequacy, security and accommodation afforded by their service but also with respect to their compliance with this Act and any other law, with the orders of the Commission and with the charter and franchise requirements.

220 ILCS 5/4-101

Prepared by,

---

Theresa Ebrey  
Accountant  
Financial Analysis Division

---

Harold Stoller  
Manager  
Energy Division

Approved by,

---

Gene Beyer  
Director  
Public Utilities Bureau